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Supreme Court, U.S.
FILED
JUL 18 1988
JOSEPH F. SPANIOL, JR.
CLERK

No. 87-1889

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

AMERICAN EXPRESS TRAVEL RELATED SERVICES COMPANY, INC., *et al.*,

Appellants,

vs.

WASHINGTON PUBLIC POWER SUPPLY SYSTEM, *et al.*,

Appellees.

ON APPEAL FROM THE SUPREME COURT OF WASHINGTON

MOTION TO DISMISS OR AFFIRM

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QUESTIONS PRESENTED

(1) Does 28 U.S.C. § 1257(2) confer jurisdiction upon this Court to hear an appeal of an order of a state's highest court upholding a statute of that state against a federal constitutional challenge:

(a) where the order of the state's highest court remands the case for further proceedings, and thus is not on its face a final judgment or order of that court; and

(b) where the order of the state's highest court cannot possibly fit any of the exceptions to the final order rule under the doctrine of *Cox Broadcasting Corp. v. Cohn*, 420 U.S. 469 (1975)?

(2) Does a ruling by the highest court of a state, upholding a statute of that state against an Equal Protection challenge, present a substantial federal question, where:

(a) the parties asserting the challenge are not within the group the statute purportedly excludes;

(b) the statute was enacted to conform state law to federal law standards and to provide protection for public issuers of securities; and

(c) the reviewing court found a number of rational bases for the distinction?

(3) Does a ruling by the highest court of a state, upholding a statute against a Commerce Clause challenge, present a substantial federal question, where:

(a) the parties asserting the challenge do not have any distinct and palpable injury traceable to the alleged burden on interstate commerce, and are not persons allegedly affected by the statutory distinctions;

(b) the statute does not seek to regulate commerce and has no practical effect on interstate commerce; and

(c) the statute was enacted in furtherance of a legitimate local public interest?

(4) Does a ruling by the highest court of a state, upholding a statute of that state against a Due Process challenge, present a substantial federal question, where:

(a) the statute did not alter an existing judgment, but merely clarified the standard of culpability in an existing cause of action; and

(b) the statute was enacted through a public legislative process in which the challenging parties had an opportunity to participate and be heard?

PARTIES BELOW

The list of parties to this appeal may be found at page 136A of the Appendix to the Jurisdictional Statement of the Appellants, and is incorporated herein by reference.

STATEMENT PURSUANT TO RULE 28.1

The Statement Pursuant to Rule 28.1 may be found in an attachment to this brief.

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Appellants,

vs.

WASHINGTON PUBLIC POWER SUPPLY SYSTEM, *et al.*,

Appellees.

ON APPEAL FROM THE SUPREME COURT OF WASHINGTON

MOTION TO DISMISS OR AFFIRM

Appellees[1] move this Court to dismiss the appeal herein or, in the alternative, to affirm the judgment of the Supreme Court of Washington on the grounds that the purported federal questions raised on this appeal are so insubstantial as to require no further argument.

[1] Appellee-defendants joining this motion are listed at the end of this brief, along with their counsel. All appellees joining in this motion are also joining in a companion motion to dismiss another appeal from the same order and decision filed by certain other plaintiffs, Fredric Haberman, *et al.* v. Washington Public Power Supply System, *et al.*, No. 87-1897.

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

Appellant-Intervenors assert jurisdiction for this appeal under 28 U.S.C. § 1257(2), which provides:

> Final judgments or decrees rendered by the highest court of a State in which a decision could be had, may be reviewed by the Supreme Court as follows:
>
> * * *
>
> (2) By appeal, where is drawn in question the validity of a statute of any state on the ground of its being repugnant to the Constitution, treaties or laws of the United States, and the decision is in favor of its validity.

Appellant-Intervenors challenge the validity of Wash. Rev. Code § 21.20.430(7)(1987), generally known as the "Scienter Amendment", which states:

> Notwithstanding subsections (1) through (6) of this section, if an initial offer or sale of securities that are exempt from registration under RCW 21.20.310 is made by this state or its agencies, political subdivisions, municipal or quasi-municipal corporations, or other instrumentality of one or more of the foregoing and is in violation of RCW 21.20.010(2), and any such issuer, member of the governing body, committee member, public officer, director, employee, or agent of such issuer acting on its behalf, or person in control of such issuer, member of the governing body, committee member, public officer, director, employee, or agent of such person acting on its behalf, materially aids in the offer or sale, such person is liable to the purchaser of the security only if the purchaser establishes scienter on the part of the defendant. The word "employee" or the word "agent," as such words

> are used in this subsection, do not include a bond counsel or an underwriter. Under no circumstances whatsoever shall this subsection be applied to require purchasers to establish scienter on the part of bond counsels or underwriters. The provisions of this subsection are retroactive and apply to any action commenced but not final before July 27, 1985. In addition, the provisions of this subsection apply to any action commenced on or after July 27, 1985.

Wash. Rev. Code § 21.20.010(2)(1987) provides:

> It is unlawful for any person, in connection with the offer, sale or purchase of any security, directly or indirectly:
>
> * * *
>
> (2) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading.

Thus, the statute at issue here merely clarifies when "scienter" must be proven to recover any damages allegedly arising from a violation of Wash. Rev. Code § 21.20.010(2).

Appellant-Intervenors assert that the Scienter Amendment violates U.S. Const., Art. l, Section 8, Clause 3, which provides:

> The Congress shall have Power . . . [t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes.

Appellant-Intervenors further assert that the Scienter Amendment violates U.S. Const., Amend. XIV, Section 1, which provides:

> [N]or shall any state deprive any person of . . . property, without due process of law.
>
> * * *
>
> [N]or deny to any person within its jurisdiction the equal protection of the laws.

STATEMENT OF THE CASE

Appellants, the American Express Companies and United States Trust Company ("Intervenors"), are intervenors in a lawsuit pending in the Washington state courts. They seek to recover losses that allegedly arose due to misrepresentations made in connection with the sale of municipal bonds issued by the Washington Public Power Supply System (the "Supply System"), a municipal corporation organized under the laws of the state of Washington. The Supply System issued the bonds between 1977 and 1981 in the principal amount of $2.25 billion to finance the construction of two nuclear projects for electricity generation in the state of Washington (the "Projects"). Intervenors purchased approximately $360 million of these bonds.

The Bond Resolution, pursuant to which the bonds were issued and sold, provided that debt service obligations on the bonds would be satisfied under the terms of certain "Participants' Agreements." The Participants' Agreements were agreements between the Supply System and 88 public utility entities in the Pacific Northwest (the "Participants"). These agreements provided for the purchase of shares of the generating "capability" of the Projects. If the Projects were completed, the Supply System would pay debt service by selling the Projects' electricity to the Participants. In addition, the Participants' Agreements provided that, if the Projects were not completed, the Participants would pay the debt service obligations according to the same share formula under which they had agreed to purchase electricity. Because the Supply System terminated construction on the Projects in January of 1982, when the Projects were still far from complete, this second prong of the Participants' Agreements came into play.

Shortly after the termination of the Projects in January, 1982, Chemical Bank, Trustee for the Projects' bond fund, filed a declaratory judgment action in the Washington state courts seeking a declaration that the Participants' Agreements were valid and enforceable. On June 15, 1983, the Supreme Court of Washington held certain of the Participants' Agreements void

ab initio. *Chemical Bank v. WPPSS*, 99 Wash. 2d 772, 666 P.2d 329 (1983). This decision hinged on a legal finding that it was an *ultra vires* act for the Washington municipal Participants to enter the Participants' Agreements. On November 6, 1984, the Supreme Court of Washington reaffirmed this *ultra vires* decision, and then held all the other Participants' Agreements unenforceable on the grounds of mutual mistake and commercial frustration. *Chemical Bank v. WPPSS*, 102 Wash. 2d 874, 691 P. 2d 524 (1984), *cert. denied*, 471 U.S. 1065 (1985). As a result of these decisions, no funds were available to the Supply System to make the required payments on the bonds, and a payment default ensued.

Intervenors filed their first so-called "complaint in intervention" in November of 1984. The Washington state action into which they intervened, *Haberman v. Washington Public Power Supply System*, Superior Court for King County, Washington, No. 84-2-06452-8, had commenced in May of 1984. Prior to that time, several securities fraud class-actions on behalf of Supply System bond purchasers had already been commenced in the federal courts. Numerous federal class-actions have since been consolidated in a multi-district proceeding (the "MDL-551" case), and two classes of bond purchasers have been certified. MDL-551 is set to begin trial on September 7 of this year in Tucson, Arizona, with The Honorable William D. Browning of the District of Arizona presiding. All of the misrepresentation claims pursued by Intervenors are present in the MDL-551 federal class-action. As Intervenors admit (Intervenors' Jurisdictional Statement, p. 9), they are members of at least one of the plaintiff classes in MDL-551.

Intervenors have eleven (11) alleged counts in their complaint, including a claim against Chemical Bank as bond fund Trustee, several so-called derivative claims, claims for damages under Washington's Consumer Protection Act and New York's General Business Law, and claims for common law fraud and negligent misrepresentation. The only claims in Intervenors' complaint that are in issue on this purported appeal arise under the Washington State Securities Act ("WSSA") Wash. Rev. Code

§ 21.20.010 *et seq.* (1987). This Act permits private lawsuits for violations of certain of its provisions under limited circumstances. A brief review of the relevant provisions of WSSA, and some of the pertinent legislative history, will highlight the issues that Intervenors pursue here.

WSSA is a relatively standard collection of statutory provisions governing the purchase, sale or issuance of securities in the state of Washington. Like most such state regulatory schemes, it parallels the federal securities laws to a large extent. Under Wash. Rev. Code § 21.20.010, certain types of acts are specifically forbidden in the purchase or sale of securities. Wash. Rev. Code. § 21.20.430 is a provision that permits private actions in the event of a violation of Wash. Rev. Code § 21.20.010. Intervenors have two claims under Section 21.20.430, one for primary liability under Section 21.20.430(1), and the other charging secondary liability under Section 21.20.430(3).

Prior to 1980, it was commonly understood that recovery in a private action under WSSA required proof of fraud, *i.e.* proof that a violation was committed with intent to defraud, or with scienter. *See, e.g., Ludwig v. Mutual Real Estate Investors*, 18 Wash. App. 33, 567 P.2d 658 (1977). But in *Kittilson v. Ford*, 93 Wash.2d 223, 608 P.2d 264 (1980), the Washington Supreme Court held that under some circumstances scienter need *not* be proven for a violation of Wash. Rev. Code § 21.20.010(2), which provides:

> It is unlawful for any person, in connection with the offer, sale or purchase of any security, directly or indirectly:
>
> * * *
>
> (2) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading.

The basic rationale offered in *Kittilson* for not requiring proof of scienter for a violation of this provision appears to have been simply that this provision did not use the words "fraud" or "defraud".

Concerned that public servants could be held liable for simple negligence under this newly announced standard, the Washington legislature promptly enacted a "Scienter Amendment" to WSSA. This amendment insured that a scienter standard would apply to WSSA claims related to the securities of certain Washington public entities. As originally enacted in 1981, the Scienter Amendment provided:

> [I]f an initial offer or sale of securities by the state or its agencies is in violation of RCW 21.20.010(2), each member of the governing body or person in control of the state or agency, each committee member, public officer, or director acting on its behalf, and each employee thereof who materially aids in the offer or sale, are liable to the purchaser of the security only if the purchaser establishes scienter on the part of the defendant.

(Wash. Laws of 1981, ch. 272, § 9(7).) Thus, the new statute mandated that when a security was issued by the state or one of its agencies, a scienter standard would apply to any WSSA claim arising out of that issue and directed at certain persons or entities related to the issuer.

In 1985, the Washington state legislature broadened this scienter requirement. (Wash. Laws of 1985, ch. 171, § 1(7).) This 1985 amendment changed the scienter requirement as follows:

> – It broadened the class of public issuers covered by the provision by adding "political subdivisions, municipal or quasi-municipal corporations, or other instrumentality of one or more of the foregoing";
>
> – It added the municipal issuer itself and the "agents" of the issuer to the list of persons to whom the scienter standard applies;

– It restricted the provision to apply only to municipal issues "exempt from registration under RCW 21.20.310," in keeping with the well-established statutory distinctions related to municipal securities; and

– It expressly excluded bond counsel and underwriters from the scienter standard.

This was where the law stood in October of 1985, when the state trial court dismissed Intervenors' entire complaint on the grounds that none of its counts stated a cognizable cause of action. (The trial court's oral decision and subsequent written order and judgment appear in the Intervenors' Appendix to their Jurisdictional Statement at pp. 87a-104a.) This dismissal decision then came before the Supreme Court of Washington on direct appeal. In the Washington Supreme Court, Intervenors challenged the constitutionality of the Scienter Amendment, and also disputed almost every other aspect of the trial court's dismissal decision. On October 8, 1987, the Supreme Court of Washington reversed the trial court's dismissal decision on a number of grounds. While the Washington Supreme Court upheld the constitutionality of the Scienter Amendment, it reinstated Intervenors' WSSA claims, as well as their claims for common law fraud and negligent misrepresentation. The court then remanded the case for further proceedings consistent with its opinion. *Haberman v. Washington Public Power Supply System*, 109 Wash.2d 107, 744 P.2d 1032 (1987), *modified and further reconsideration denied*, ____ Wash.2d ____, 750 P.2d 254 (1988).[2]

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[2] Between the trial court decision and the Washington Supreme Court decision, the Washington legislature amended the Scienter Amendment again, but only to make it clear that it applied retroactively (the "Retroactivity Amendment"). (Wash. Laws of 1986, ch. 304, § 7.) The version of the Scienter Amendment reviewed by the Washington Supreme Court, and thus the version before this Court, is the current law which contains the retroactive implementation language.

ARGUMENT

I.

THIS COURT LACKS JURISDICTION TO HEAR THIS PURPORTED APPEAL BECAUSE THE ORDER AT ISSUE IS MANIFESTLY NOT FINAL.

Intervenors purportedly bring this appeal under 28 U.S.C. § 1257(2), which grants jurisdiction to this Court to hear appeals of certain "[f]inal judgments or decrees rendered by the highest court of a State in which a decision could be had." But the decision in this case does not contain a "final" order or judgment. Although the Washington Supreme Court upheld the constitutionality of the Scienter Amendment, the decision on Intervenors' WSSA claims clearly permits them to pursue those causes of action on remand. Likewise, Intervenors can freely pursue their reinstated common law fraud claim, as well as their negligent misrepresentation claim. Success on any of these remanded claims could result in complete recovery for Intervenors and would entirely moot the issue Intervenors pursue here. Accordingly, this case is not ripe for review, and this appeal should be dismissed.[3]

A. The Washington Supreme Court's Order Is Not Final On Its Face.

The Washington Supreme Court remanded several of Intervenors' claims for trial, and thus clearly did not render a decision that "ends the litigation on the merits and leaves nothing for the court to do but execute the judgment." *Stringfellow v. Concerned Neighbors in Action*, __ U.S. __, 107 S. Ct. 1177, 1181 (1987), *quoting Catlin v. United States*, 324 U.S. 229, 233 (1945).

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[3] Dismissal of this appeal and the companion appeal would mandate dismissal of the cross-appeal of defendant Wood Dawson Smith & Hellman, since they have asserted no basis for this Court's jurisdiction over their cross-appeal other than the existence of the primary appeals. (*See* Wood Dawson Jurisdictional Statement on Cross-Appeal, pp. 6-7.)

Intervenors nevertheless seek to invoke this Court's appellate jurisdiction under the doctrine of *Cox Broadcasting Corp. v. Cohn*, 420 U.S. 469 (1975). But the doctrine of that case demands that any prospective appeal satisfy a set of specific criteria. Intervenors are simply unable to fit the facts of their case within the *Cox* standards.

B. The *Cox Broadcasting* Doctrine Does Not Apply To This Order.

In *Cox Broadcasting*, this Court recognized four narrow exceptions to the requirement of strict finality. 420 U.S. at 476-87. Intervenors urge this Court to find jurisdiction within the second and the fourth exceptions identified in *Cox Broadcasting*. But the facts of this case do not fit either of those *Cox* exceptions.[4]

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[4] In *Cox*, this Court enumerated the following four situations in which it would review a non-final order of a state's highest court deciding a federal issue:

> 1. Where further proceedings have yet to occur, but the federal issue, as decided by the state's highest court, preordains the outcome of those proceedings, making the case "final" for all practical purposes. 420 U.S. at 479 ("the first *Cox* exception").
>
> 2. Where the federal issue will necessarily survive and require review, regardless of the eventual outcome of the state proceedings. *Id.* at 480 ("the second *Cox* exception").
>
> 3. Where the federal question could never again be reviewed by this Court, no matter what the outcome of the state proceedings. *Id.* at 481 ("the third *Cox* exception").
>
> 4. Where: (a) reversal by this Court on the federal issue would be preclusive of any further litigation; and (b) the state court decision might seriously erode federal policy. *Id.* at 482-83 ("the fourth *Cox* exception").

1. *The Present Case Does Not Fall Within The Second* Cox Broadcasting *Exception Because The Federal Issue Will Not Necessarily Survive After Further State Proceedings.*

Intervenors first assert that this case falls into the second *Cox* exception to strict finality, arguing that there "is a federal issue which has been 'finally decided by the highest court in the State' and which 'will survive and require decision regardless of the outcome of further state court proceedings.' " (Intervenors' Jurisdictional Statement, p. 3, *quoting Cox*, 420 U.S. at 480.) This statement is incorrect. Intervenors would have no reason to challenge the Scienter Amendment if they prevailed at trial using the higher standard of culpability of that legislation. Moreover, Intervenors could win on several other claims in their complaint. Because further state court proceedings could yet render review of Intervenors' constitutional claims unnecessary, the second *Cox* exception to finality does not apply to this case.

It is also noteworthy that this Court defined the second *Cox* exception with reference to cases where a defendant needs protection from immediate harm.[5] This factor further distinguishes the present case, since Intervenors, who are plaintiffs, are not being forced to give up control of any property or endure a trial that might endanger their civil liberties. Indeed, Intervenors demonstrate no special hardship indicating that expedited review would be appropriate in this case. Intervenors have manifestly not met the second *Cox* exception as a basis for this Court's jurisdiction.

2. *The Present Case Does Not Fall Within The Fourth* Cox Broadcasting *Exception Because Reversal On The Federal Question Will Not Be Preclusive Of Further Litigation, And Because The Order In Issue Involves No Erosion Of Federal Policy.*

Intervenors also appear to base their jurisdictional statement on the fourth *Cox* exception. To fit under the fourth exception,

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[5] The cases cited by this Court in *Cox Broadcasting* in support of the second category all arguably involve elements of immediate hardship. Wright, Miller, *(Footnote continued)*

an appellant has to show *both* (1) that "reversal of the state court on the federal issue would be preclusive of any further litigation on the relevant cause of action," *and* (2) that "a refusal immediately to review the state court decision might seriously erode federal policy." 420 U.S. at 482-83. Intervenors do not even argue that they meet these necessary criteria. Instead, they merely assert that "delay of review . . . will leave the securities market in Washington operating under a 'rule of law and a statute the constitutionality of which is in serious doubt'." (Intervenors' Jurisdictional Statement, p. 3, *quoting Cox* 420 U.S. at 485-86.)

In the first place, there is little doubt, let alone "serious doubt," on the constitutional question. A Washington state trial court, the Washington Supreme Court, and now Judge Browning in the federal class-action, MDL-551, have all held that the Scienter Amendment is constitutional. *See In re WPPSS Securities Litigation*, MDL No. 551 (W.D. Wash. June 13, 1988). There is thus much less "doubt" here than Intervenors would presume.

In any case, mere "doubt" as to a constitutional issue, which could justify any number of advisory requests, has never been a basis for invoking this Court's jurisdiction. That is why this Court never identified "doubt" as to a law's constitutional validity as an independent factor in *Cox*. The passage of *Cox* cited by Intervenors – concerning "serious doubt" on a constitutional question – is pure dicta. Such a concern is applicable, if at all, only to the second element of the fourth *Cox* exception – whether there will be a serious erosion of federal policy.

Intervenors do not contend, as they could not, that any erosion of federal policy is at risk here. This is certainly not a case where First Amendment rights will be chilled if the state decision is left unreviewed. *Cf. Cox*, 420 U.S. at 485-86. Nor is this a case where a federal statutory scheme will be undermined if an incorrect state court decision is left standing. *Cf. Southland*

Cooper & Gressman, *Federal Practice and Procedure: Jurisdiction* § 4010. Commentators suggest that this category makes more sense with such a requirement. *Id.*

Corp. v. Keating, 465 U.S. 1, 6-7 (1984)(Federal Arbitration Act); *Hudson Distributors, Inc. v. Eli Lilly & Co.*, 377 U.S. 386, 395 (1964) (Sherman Act); *Mercantile National Bank v. Langdeau*, 371 U.S. 555, 558-62 (1963)(National Banking Act). To the contrary, the Washington Supreme Court decision requires Appellants to try their state law securities claims under a scienter standard of proof *consistent* with the federal securities law scheme. *See Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193, *rehearing denied*, 425 U.S. 986 (1976) (scienter is an essential element of a federal securities law fraud claim under § 10(b) of the Securities Exchange Act of 1934).

In any event, even if "doubt" satisfied the second element of the fourth *Cox* exception, Intervenors cannot satisfy the first element — that a reversal by this Court would be preclusive of further litigation. This first element *must* be satisfied to meet the fourth *Cox* exception. *Cox*, 420 U.S. at 482-83; *accord Southland Corp.*, 465 U.S. at 6-7. Here, it manifestly is not.

The resolution of Intervenors' constitutional claims "can await final judgment without any adverse effect upon important federal interests. A contrary conclusion would permit the fourth [*Cox*] exception to swallow the rule." *Flynt v. Ohio*, 451 U.S. 619, 622 (1981). This appeal should be dismissed.

II.

THE INTERVENORS LACK STANDING TO RAISE EQUAL PROTECTION AND COMMERCE CLAUSE CLAIMS.

Litigants must normally assert their own legal interests, rather than those of a third party. *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797, 804 (1985). Where a party is not adversely affected by the part of a statute it seeks to challenge, it lacks standing to do so. *Jones v. Preuit & Mauldin*, 822 F.2d 998, 1006 (11th Cir. 1987). That is precisely the situation pertaining to the Intervenors' Equal Protection and Commerce Clause claims, and they therefore lack standing to pursue these claims.

Intervenors try to raise an Equal Protection challenge to the Scienter Amendment based on the fact that it differentiates bond counsel and underwriters from other prospective defendants. But Intervenors are not bond counsel or underwriters, and are not adversely affected by the exemption of bond counsel and underwriters from the scienter requirement. In fact, the Intervenors are benefited by a negligence, rather than scienter, standard for those entities.

Similarly, Intervenors do not have standing to raise an Equal Protection or Commerce Clause challenge to the distinction between in-state and out-of-state bond issues. All bonds in question were issued by the Supply System, a municipal corporation of the State of Washington. There are no non-Washington issuers involved in this case or this appeal. Thus, Intervenors are not adversely affected by any asserted unconstitutional distinction in this respect.

This Court has "narrowly limited the circumstances in which one party will be given standing to assert the legal rights of another." *Duke Power Co. v. Carolina Environmental Study Group*, 438 U.S. 59, 80 (1978). "Even when the plaintiff has alleged injury sufficient to meet the 'case or controversy' requirement, this Court has-held that the plaintiff must assert ***his own legal rights and interests***, and cannot rest his claim to relief on the legal rights or interests of third parties." *Id.*, *quoting Warth v. Seldin*, 422 U.S. 490, 499 (1975)(emphasis added).

The requirement of standing is constitutionally based. Thus, "[a] plaintiff must allege personal injury fairly traceable to the defendant's allegedly unlawful conduct and likely to be redressed by the requested relief." *Allen v. Wright*, 468 U.S. 737, 751, *rehearing denied*, 468 U.S. 1250 (1984), *citing Valley Forge Christian College v. Americans United for Separation of Church and State, Inc.*, 454 U.S. 464, 472 (1982). The injury alleged must be distinct and palpable, and not abstract, conjectural or hypothetical. *Id.*, at 751.

Intervenors assert that the Scienter Amendment's alleged impermissible burden on interstate commerce has "directly harmed" them. But they recite no facts which would support an

inference of any harm, direct or indirect. Accordingly, the Court should reject Intervenors' Equal Protection and Commerce Clause challenges to the Scienter Amendment for lack of standing.[6]

III.

THE SCIENTER AMENDMENT DOES NOT VIOLATE THE EQUAL PROTECTION CLAUSE.

Intervenors contend that the provision in the Scienter Amendment stating that bond counsel and underwriters are not within the ambit of the scienter requirement unconstitutionally singles out a class for special treatment.[7] Intervenors further contend that the limitation in the Scienter Amendment to situations involving bonds issued by the State of Washington or its political subdivisions unconstitutionally distinguishes between in-state and out-of-state bond issues and, as a result, violates both the Equal Protection Clause and Commerce Clause. Neither argument provides a jurisdictional basis for consideration by this Court.

Even if the standing barriers demonstrated above could be overcome, Intervenors assert no substantial federal question. The

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[6] The cases cited by Intervenors do not support the proposition that they may raise other constitutional issues without standing to do so. In *Federal Communications Commission v. Sanders Brothers Radio Station*, 309 U.S. 470 (1940), this Court upheld a radio station licensee's standing to object to the FCC's grant of a license to a competitor because *Congress had conferred legislative standing* to the licensee. 309 U.S. at 477. Furthermore, in *Duke Power Co. v. Carolina Environmental Study Group, Inc.*, 438 U.S. 59 (1978), this Court did *not* abandon the constitutional requirement that there be a causal link between the alleged injury and the challenged conduct. *See* 438 U.S. at 78.

[7] Appellees note that Wood Dawson filed a cross-appeal on the issue of Equal Protection. Appellees do not intend to file a separate response to Wood Dawson's cross-appeal, but the arguments in this response will apply to the Wood Dawson submission where appropriate.

Scienter Amendment, of course, is clothed in a presumption of constitutionality. Intervenors bear the heavy burden of showing that the Scienter Amendment is unconstitutional. *McGowan v. Maryland*, 366 U.S. 420, 425-26 (1961). They have not and cannot satisfy this standard.

A. The Scienter Amendment Does Not Single Out Bond Counsel And Underwriters For Special Treatment.

An Equal Protection claim requires at the outset that a class be singled out for separate treatment from all other similarly situated persons or entities. *See City of Cleburne v. Cleburne Living Center*, 473 U.S. 432, 439 (1985); *Plyler v. Doe*, 457 U.S. 202, 216, *rehearing denied*, 458 U.S. 1131 (1982). That is not the case here. The Scienter Amendment imposes a scienter standard in actions against the following defendants:

> (1) an issuer, when the issuer is the State, its agencies, political subdivisions, municipal or quasi-municipal corporations, or other instrumentality of the above; and
>
> (2) a member of the governing body, committee member, public officer, director, employee, or agent of such issuer acting on its behalf; and
>
> (3) a person in control of (1) or (2).

Wash. Rev. Code § 21.20.430(7). *For any other person or entity*, the standard for liability continues to be negligence, not scienter. The Scienter Amendment also provides clarification of the definitions of "employee" and "agent" as used in the statute, by stating that bond counsel and underwriters are not to be considered "agents" or "employees" for purposes of the scienter requirement. *Id.*

The Scienter Amendment, thus, does not single out bond counsel and underwriters for special treatment. The statute does not require that scienter be proved against everyone other than

bond counsel or underwriters. Rather, it provides the "protection" of a scienter requirement to the limited class of entities and persons typically most closely associated with the issuer of securities, and excludes all others. Thus, Intervenors have failed to establish the principal underpinning for their Equal Protection claim – that the State of Washington created a distinction between bond counsel and underwriters on the one hand, and other similarly situated persons involved in the process of issuing municipal securities.[8]

B. Intervenors Have Failed To Meet The Heavy Burden Of Showing That The Scienter Amendment Lacks Any Conceivable Rational Relationship To A Legitimate State Interest.

Even if Intervenors could satisfy the requirement that they were singled out from all others for special treatment, they must then – and cannot – prove that: 1) the State of Washington has no legitimate interest in providing the "protection" of a scienter requirement to the specified group of defendants, and 2) the Scienter Amendment bears no conceivable rational basis to that legitimate state interest.

Intervenors concede that the Scienter Amendment does not affect fundamental rights or involve suspect classifications. Therefore, it does not violate the Equal Protection Clause if its classifications bear any rational relationship to a legitimate state interest. *City of Cleburne v. Cleburne Living Center*, 473 U.S.

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[8] Intervenors' contention that bond counsel and underwriters are singled out for discrimination under the Scienter Amendment because they are politically unpopular groups, citing *United States Dep't of Agriculture v. Moreno*, 413 U.S. 528 (1973), borders on the frivolous. In *Moreno*, this Court struck down an amendment preventing "hippies" from receiving food stamps. Any analogy to alleged discrimination here against "New York bond counsel and Wall Street underwriters," *see* Intervenors' Jurisdictional Statement at 21, is at best illusory.

432, 440 (1985).[9] Classifications are to be set aside on Equal Protection grounds "only if they are based solely on reasons totally unrelated to the pursuit of the State's goals and only if no grounds *can be conceived* to justify them." *Clements v. Fashing*, 457 U.S. 957, 963, *rehearing denied*, 458 U.S. 1133 (1982)(emphasis added). Therefore, Intervenors must show that the Scienter Amendment was wholly without a conceivable legitimate purpose or state interest.

The Scienter Amendment was enacted to reinstate the long-standing scienter requirement for actions against public issuers of securities (*see* pp. 6-8, *supra*), and to conform Washington law to federal securities laws in this respect. *See* Wash. Rev. Code § 21.20.900 (1987). The clear and legitimate state interest in such a standard is the protection of those persons and entities who are serving in the public interest, thus encouraging their service to the public and thereby facilitating the issuance of municipal securities. A scienter standard helps ensure that this public purpose will be served and that persons well-qualified for public office will not be deterred from service. The facilitation of the issuance of municipal securities for necessary public projects is clearly a legitimate state interest.

Having established the legitimate purpose, "the state law stands as long as the burden it imposes is found to be rationally related to that purpose, *a relationship that is not difficult to establish.*" *Metropolitan Life Ins. Co. v. Ward*, 470 U.S. 869, 881, *rehearing denied*, 471 U.S. 1120 (1985) (emphasis added). Any conceivable rational basis for an allegedly impermissible statutory distinction will sustain the legislation. *Allied Stores of Ohio v. Bowers*, 358 U.S. 522, 528 (1959). Intervenors have

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[9] Statutes establishing immunities from tort actions have withstood Equal Protection challenges so long as they are rationally related to a legitimate state interest. *Edelstein v. Wilentz*, 812 F.2d 128, 131-33 (3d Cir. 1987); *Logan v. Hollier*, 699 F.2d 758 (5th Cir. 1983).

not met their burden of demonstrating the lack of any conceivable rational relationship between the alleged classification and the legitimate state purposes underlying the legislation.[10]

The Washington Supreme Court noted a number of reasonable bases for a distinction between bond counsel (and underwriters) and others involved in the issuance of municipal securities. *Haberman v. Washington Public Power Supply System*, 109 Wash.2d 107, 744 P.2d 1032 (1987), *modified and further reconsideration denied*, __ Wash. 2d __, 750 P.2d 254 (1988). These "rational bases" included primarily the expertise of bond counsel and underwriters, the role they play in the process of issuing municipal securities, the reliance placed on bond counsel's opinions, and their form of compensation. *Id.*

In addition to the factors addressed at length by the Washington Supreme Court in *Haberman*, there are other related conceivable rational bases as well. For example, bond counsel and underwriters typically perform their own analysis of municipal bonds and their issuer. Investors often rely on this

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[10] A rational basis for a legislative enactment need not have provided the actual motivation for the legislature's decision. *United States R.R. Retirement Board v. Fritz*, 449 U.S. 166, 179 (1980), *rehearing denied*, 450 U.S. 960 (1981).

> States are not required to convince the courts of the correctness of their legislative judgments . . . .
>
> . . . [P]arties challenging legislation under the Equal Protection Clause . . .cannot prevail so long as "it is evident from all the considerations presented to [the legislature], and those of which we may take judicial notice, that the question is at least debatable."

Minnesota v. Clover Leaf Creamery Co., 449 U.S. 456, 464, *rehearing denied*, 450 U.S. 1027 (1981), *quoting United States v. Carolene Prods. Co.*, 304 U.S. 144, 154 (1938). This Court recognized in *Schweiker v. Wilson*, 450 U.S. 221, 234 (1981), *quoting Massachusetts Bd. of Retirement v. Murgia*, 427 U.S. 307, 314 (1976), that:

> This [Equal Protection] inquiry employs a relatively relaxed standard reflecting the Court's awareness that the drawing of lines that create distinctions is peculiarly a legislative task and an unavoidable one. Perfection in making the necessary classifications is neither possible nor necessary.

analysis for confirmation of the accuracy of the information about the issue. Requiring bond counsel and underwriters to answer to a negligence standard is an appropriate and rational distinction supporting the state's undisputed legitimate interest in providing accurate and reliable information to potential investors in municipal securities.

The scienter standard's distinction serves to encourage well-qualified individuals to serve as public officials without fear of unlimited personal liability, while balancing the protection provided purchasers of affected securities. It promotes public bodies' and officials' devotion of their time to developing and implementing necessary public projects, rather than defending litigation brought against them and public issuers.

These rational bases for the Scienter Amendment plainly pass constitutional muster. Even if bond counsel and underwriters are considered a class distinct from all other entities and individuals involved in the issuance of municipal bonds, holding them to a negligence standard is rationally related to a legitimate state interest and, therefore, does not violate the Equal Protection Clause.

C. The Scienter Amendment Is Legitimately Limited To Washington State Securities And Does Not Violate The Equal Protection Clause In That Respect.

Intervenors contend that the Scienter Amendment's distinction between bonds issued by the State of Washington and its political subdivisions, and those bonds issued by other states, is an improper distinction violating the Equal Protection Clause.[11] Intervenors seek to characterize the Scienter Amendment as providing preferential treatment for residents to the detriment of non-residents. Although the Equal Protection Clause can be implicated where a state discriminates against out-of-state entities

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[11] The Washington Supreme Court held that Intervenors lacked standing to assert this claim and rejected their Equal Protection challenge to the Amendment without addressing the merits. *Haberman*, 109 Wash.2d at 138, 744 P.2d at 1055. This ruling was correct. *See* Section II, *supra*.

in favor of in-state entities, the Scienter Amendment creates no such discrimination. This is not the type of statute struck down in *Metropolitan Life Ins. Co. v. Ward*, 470 U.S. 869, *rehearing denied*, 471 U.S. 1120 (1985), in which in-state insurance companies were taxed at a lower rate than out-of-state insurance companies, with no conceivable purpose other than to promote domestic industry and investment. To the contrary, the statute at issue here is part of a comprehensive statutory framework regulating the activities of Washington municipal corporations and political subdivisions. As part of that system of regulation, it is plainly rational for the legislature to define the standard of liability relating to bonds issued by Washington political subdivisions.

For all of these reasons, Intervenors' Equal Protection arguments are without merit.

IV.

INTERVENORS' COMMERCE CLAUSE CHALLENGE TO THE SCIENTER AMENDMENT IS UNFOUNDED.

Intervenors' Commerce Clause argument is equivalent to their an Equal Protection argument and is just as pointless. Intervenors can show no burden upon interstate commerce, as none exists. Moreover, they are seeking to assert the interests of non-Washington public issuers. Intervenors clearly have no standing to raise the rights of non-Washington public issuers, whether within a Commerce Clause or an Equal Protection argument. But, even if they did have standing, their Commerce Clause challenge would be without merit.

A. The Scienter Amendment Does Not Seek To Regulate Commerce.

The purpose of the Commerce Clause is to protect the free movement of commerce across state lines. *See Massachusetts v. United States*, 435 U.S. 444, 462 (1978). Statutes found invalid under that clause are those which effect economic protectionism

by overtly blocking the flow of interstate commerce at a state's borders. *See Philadelphia v. New Jersey*, 437 U.S. 617, 624 (1978). As this Court recently noted in *New Energy Company of Indiana v. Limbach*, 56 U.S.L.W. 4475, 4477 (May 31, 1988):

> The Commerce Clause does not prohibit all state action designed to give its residents an advantage in the marketplace, but only action of that description *in connection with the State's regulation of interstate commerce.*

(Emphasis in original.)

The Scienter Amendment *in no manner seeks to regulate interstate commerce*; it affects only the standard of liability of an element of a cause of action created by the Washington legislature. Accordingly, the Commerce Clause simply does not apply.

B. The Scienter Amendment Has No Practical Effect Upon Interstate Commerce.

The burden of showing discrimination under the Commerce Clause rests on the party challenging the validity of the statute. *Hughes v. Oklahoma*, 441 U.S. 322, 336 (1979). To succeed on a Commerce Clause claim, the party challenging the statute must demonstrate real and substantial injury. *See, e.g., Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984).

In assessing Commerce Clause challenges, courts look to the practical effect of the challenged conduct. *Lewis v. BT Investment Managers, Inc.*, 447 U.S. 27, 37 (1980). Thus, in *Exxon Corp. v. Governor of Maryland*, 437 U.S. 117, 126, *rehearing denied*, 439 U.S. 884 (1978)(emphasis added), the Court found that the challenged legislation did not violate the Commerce Clause, stating:

> In fact, the Act [regulation of producer/refiner's right to operate retail service station within state] *creates no barriers whatsoever* against interstate independent dealers; it does not prohibit the flow of interstate goods, place added costs upon them, or distinguish

> between in-state and out-of-state companies in the retail market. The absence of any of these factors fully distinguishes this case from those in which a state has been found to have discriminated against interstate commerce.

Generally, courts will only invalidate statutes under the Commerce Clause if they attempt to give, or in fact give, in-state commerce an unreasonable competitive advantage. *See, e.g., Bacchus Imports*, 468 U.S. at 270. Here, Intervenors' *only allegation* of burden is their surmise that non-Washington public issuers may not wish to sell bonds in Washington. But that is not enough. In *C.T.S. Corporation v. Dynamics Corporation of America*, __ U.S. __, 107 S. Ct. 1637 (1987), this Court recently considered a Commerce Clause challenge to an Indiana statute regulating acquisition of control shares in Indiana corporations. The challenge rested on a claim that tender offers for Indiana corporations would be hindered by the statute. The Court noted that there was little evidence that the Indiana Act would limit the number of successful tender offers, and stressed that the Act did not prohibit any entity – resident or non-resident – from offering to purchase or from purchasing shares in Indiana corporations. 107 S.Ct. at 1652.

Exactly the same point applies to the Scienter Amendment. No evidence is cited, and none exists, to support Intervenors' hypothetical proposition that an out-of-state public issuer would be hindered in selling its bonds in Washington.

C. The Scienter Amendment Serves A Legitimate Local Public Interest.

This Court, in *Lewis v. BT Investment Managers, Inc.*, 447 U.S. 27, 36 (1980), *quoting Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970), stated:

> Where the statute regulates evenhandedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce

> is clearly excessive in relation to the putative local benefits. . . .

In the instant case, Washington clearly has a legitimate interest in enacting the Scienter Amendment, *see* Section III, *supra*. While nothing in the Scienter Amendment would prevent a non-Washington public issuer from offering its bonds in Washington, any burden on interstate commerce would be incidental to the state's legitimate interest in defining remedial aspects of statutory causes of action.

For all of these reasons, Intervenors' Commerce Clause challenge to the Scienter Amendment is without merit.

V.

THE RETROACTIVITY OF THE SCIENTER AMENDMENT DOES NOT VIOLATE THE DUE PROCESS RIGHTS OF INTERVENORS.

Intervenors claim that they had a property interest in a negligence cause of action involving Supply System bonds, and were unconstitutionally deprived of that cause of action by retroactive operation of the Scienter Amendment. Specifically, they assert that a cause of action is a species of property protected by procedural Due Process requirements, relying on *Logan v. Zimmerman Brush Co.*, 455 U.S. 422 (1982).

Intervenors' argument is misplaced. A constitutionally protected property interest exists only to the extent recognized as such by state law. "Property interests are not created by the Constitution, 'they are created and their dimensions are defined by existing rules or understandings that stem from an independent source such as state law. . . .' " *Cleveland Board of Education v. Loudermill*, 470 U.S. 532, 538 (1985), *quoting Board of Regents v. Roth*, 408 U.S. 564, 577 (1972). Washington law has long held that there is no vested right to a statutorily created tort claim until a final, unreviewable judgment has been obtained. *Seattle Rendering Works, Inc. v. Darling-Delaware Co.*, 104 Wash.2d 15, 19, 701 P.2d 502, 505 (1985); *Johnson v. Continental West, Inc.*, 99 Wash.2d 555, 563, 663 P.2d 482, 486

(1983). No judgment had been entered in favor of Intervenors at the time the legislature enacted the Scienter Amendment, or at the time its retroactivity was clarified. Accordingly, Intervenors had no constitutionally protected property interest in the negligence standard. That inescapable conclusion effectively ends the Due Process inquiry.

A. Intervenors Received Procedural Due Process.

Even assuming, *arguendo*, that a non-vested cause of action were considered a species of property entitled to some Due Process protection, that protection is focused solely on ensuring access to fair procedures for its prosecution. *In re Consolidated United States Atmospheric Testing Litigation*, 820 F.2d 982, 989-90 (9th Cir. 1987), *cert. denied*, __ U.S. __, 108 S.Ct. 1076 (1988). Intervenors' right of access to fair procedures was not affected by the retroactive application of the Scienter Amendment. Thus, procedural Due Process has not been violated.

Intervenors single out the 1986 amendment to the 1985 Scienter Amendment, which merely clarified that the 1985 statute applied retroactively (the "Retroactivity Amendment"). Intervenors concede that "legislative process" is usually all the process that would be due with respect to a statute's enactment. (Intervenors' Jurisdictional Statement, p. 27). But they nevertheless assert that the Washington legislative process here was inadequate because they did not receive sufficient personal notice.

This argument is without merit. Both the Scienter Amendment and the Retroactivity Amendment affected all persons seeking to assert claims with respect to Washington municipal bond issues. The statutes proceeded through the legislative process – subject to public scrutiny – in the normal course. Intervenors had the same opportunity as any other interested person to inquire as to the legislature's agenda and to be heard in opposition. Where legislative enactments affect a general class of persons, those persons affected by the enactments receive procedural Due Process through the legislative process itself, and individuals within the general class have no right to individual

attention. *United States v. LULAC*, 793 F.2d 636, 648 (5th Cir. 1986).

Intervenors suggest that the Washington legislature had a pecuniary interest in the Retroactivity Amendment, and therefore any action the legislature took was in violation of procedural Due Process. They cite *Gibson v. Berryhill*, 411 U.S. 564, 576-78 (1973), and assert that the legislature was protecting in-state ratepayers and punishing out-of-state bondholders. This argument is unavailing.

In *Gibson*, this Court held that a statutory body with the authority to issue, suspend and revoke licenses for the practice of optometry in Alabama could not conduct hearings on a licensing revocation request brought by the Alabama Optometric Association. The statutory body was comprised *solely* of members of the Association. This Court concluded that the bias and pecuniary interests of the members disqualified the statutory body from considering the Association's charges.

Unlike the quasi-judicial licensing proceedings in *Gibson*, the proceedings in enacting the Amendments here were entirely public proceedings of the Washington legislature. If a legislature's actions could be invalidated simply on the ground that the pecuniary interests of some state residents were affected, then virtually no legislation could withstand procedural Due Process scrutiny. This clearly is not the intent and scope of *Gibson*, nor does it make any logical sense.

B. Intervenors' Substantive Due Process Rights Were Not Violated By The Enactment Of The Retroactivity Amendment.

As demonstrated above, Intervenors had no vested right subject to Due Process requirements at all. However, even if they had a protectable property interest in their statutory negligence claim, all that substantive Due Process requires is that there be a rational basis for the retroactive operation of the Scienter Amendment.

As in an Equal Protection analysis, under a substantive Due Process analysis, a statute is presumed to be constitutional, and the burden is on the challenging party to show that it violates Due Process. *Usery v. Turner Elkhorn Mining Co.*, 428 U.S. 1, 15 (1976). Intervenors have the burden of showing that the Retroactivity Amendment was wholly arbitrary and irrational in purpose and effect and is not reasonably related to any legitimate legislative purpose. *Duke Power Co. v. Carolina Environmental Study Group*, 438 U.S. 59, 82-94 (1978); *Usery v. Turner Elkhorn Mining Co.*, 428 U.S. at 15-20. Intervenors have not and cannot meet this burden. To the contrary, as explained above, pp. 19-20, there are a number of rational bases underlying the enactment of the Scienter and Retroactivity Amendments.

Intervenors vainly attempt to invoke Commerce Clause principles, *Middle South Energy, Inc. v. Arkansas Public Serv. Comm'n*, 771 F.2d 404 (8th Cir. 1985), *cert. denied*, 474 U.S. 1102 (1986), and the separation of powers doctrine, *United States v. Klein*, 80 U.S. (13 Wall.) 128, 146 (1872), to bolster their groundless Due Process claim. (Intervenors' Jurisdictional Statement at 28.) This Court should reject this attempted "bootstrapping". The lack of merit of the Commerce Clause claim is addressed in Section IV, *supra*. So far as *Klein* is concerned, Intervenors had no vested property interest in their cause of action, thus vitiating their Due Process claim. Furthermore, *Klein* is wholly inapplicable to the Retroactivity Amendment.

First, *Klein* is a separation of powers case, not a Due Process case. Moreover, *Klein* only restricts a legislature from directing a court on how to resolve an issue of fact so as to determine the outcome of litigation. *See In re Consolidated United States Atmospheric Testing Litigation*, 820 F.2d at 992; *United States v. Brainer*, 691 F.2d 691, 695 (4th Cir. 1982). This Court has held that a legislature is not prohibited from enacting legislation that affects pending litigation, so long as the legislation does not attempt to control or dictate the court's ultimate decision in the litigation. *United States v. Sioux Nation of Indians*, 448 U.S. 371, 402-05 (1980). Neither the Scienter nor Retroactivity

Amendment attempts to dictate the ultimate outcome of litigation. They simply establish the standard for liability applicable to certain defendants. In short, the challenged statutes reflect a proper and rational legislative function, and *Klein* has no application.

CONCLUSION

For the reasons stated above, this Court should dismiss this appeal or, in the alternative, affirm the decision of the Washington Supreme Court.

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Ebasco Services
Incorporated

STATEMENT PURSUANT TO RULE 28.1

The parent of appellee PaineWebber Incorporated is Paine Webber Group, Inc. Appellees Blyth Eastman Paine Webber Incorporated and Paine Webber Jackson & Curtis, Inc. have been subsumed in the corporate entity, PaineWebber Incorporated, and no longer exist and operate as separate corporate entities. There are no PaineWebber Incorporated subsidiaries or affiliates except wholly-owned subsidiaries.

The parent of appellee Ebasco Services Incorporated is Enserch Corp. Ebasco Services Incorporated has the following subsidiaries: E&L Associates Inc.; E&L Technologies Inc.; Ebasco Constructors Inc.; Ebasco Corporation; Ebasco Energy Resources, Inc.; Ebasco Engineering and Construction Corporation; Ebasco Industries Inc. (Delaware); Ebasco International Corporation; Ebasco Overseas Corporation; Ebasco Plant Services Inc.; Ebasco Risk Management Consultants, Inc.; Ebasco Services International Inc.; and Gates Engineering Consultants.

Appellee R.W. Beck and Associates is a partnership with no corporate parents, affiliates or subsidiaries, except wholly-owned subsidiaries.

The remaining appellees joining in this motion are either municipalities or municipal corporations. They have no corporate parents, affiliates or subsidiaries.